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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 001164

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SUBJECT: MEDVEDEV-SARGSIAN: NAGORNO-KARABAKH, ECONOMICS

Classified By: Pol M/C Alice G. Wells for reasons 1.4(b) and (d)

11. (C) Summary: In a press conference after his April 23 meeting with Armenian President Sargsian, President Medvedev stressed the November 2 Moscow Declaration he personally had brokered as the basis for progress on Nagorno-Karabakh, while the MFA stated its hope the Turkey-Armenia rapprochement would benefit the negotiations. The MFA noted that Russian companies operating in Armenia saw the opening of the border to Turkey as a new export opportunity, and clarified that the approved USD 500 million loan to Armenia still required Duma passage of the budget, with additional assistance possible through the EurAsEC anti-crisis fund. Analysts see Russia's role declining in the South Caucasus, including over Nagorno-Karabakh, as a result of Turkey's diplomatic initiative. However, Armenia's decision to cancel its participation in the May 6 PfP exercises with Georgia is one indication that Moscow will not cede its "privileged interests" easily. End Summary.

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Nagorno-Karabakh  
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12. (U) In a press conference after his April 23 meeting with Armenia President Sargsian, President Medvedev stressed the November 2, 2008 Moscow Declaration signed by Sargsian and Aliyev as a common approach "based on the fundamental principles of international law" to resolving Nagorno-Karabakh, and the basis for Sargsian's and Aliyev's willingness to "move in a positive direction." Sargsian agreed, stressing that the core issue in the Nagorno-Karabakh conflict was the status question. In reference to Turkey, Sargsian welcomed the "appearance of another country that thinks of Russia as its strategic partner," which he said "increased Russia's role" in resolving the conflict. MFA spokesman Nesterenko on April 29 echoed FM Lavrov's April 16 remarks in Yerevan that the Turkey-Armenia rapprochement was a "bilateral affair," adding that Russia hoped it would "help ease tensions in the region" and "benefit the atmosphere of negotiations" on Nagorno-Karabakh.

13. (C) Calling Nagorno-Karabakh a "permanent" item on the Russia-Armenia agenda, MFA Armenia desk officer Petr Volokovykh told us April 29 that the Presidents discussed the upcoming May 7 Sargsian-Aliyev meeting in Prague. In order to counteract the "image of enmity" the conflict sides bore toward each other, Medvedev and Sargsian agreed to pursue "people's diplomacy" by staging a cultural event in the summer designed to increase the mutual understanding of the Azerbaijan and Armenia peoples.

14. (C) Volokovykh termed the Turkey-Armenia rapprochement a "bilateral issue" that Russia welcomed, but posited that the Nagorno-Karabakh resolution process should not suffer because

of it. He disagreed with the notion that Russia would lose its influence in Armenia if Turkey and Armenia normalized relations. While it was true that Russia was Armenia's greatest partner both in political and economic terms, Volokovykh noted that the Armenian market was very "narrow," and that the Russian companies operating in Armenia saw the opening of the border to Turkey as a new export opportunity.

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Economics  
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15. (U) In the press conference, Medvedev highlighted existing energy and infrastructure projects as means by which Russia was helping Armenia weather the economic crisis and protect the USD 1 billion Russian-Armenia trade relations and USD 2.5 billion Russian investment in Armenia. He singled out as examples the joint construction of a civilian nuclear plant and development of uranium mines. Calling Armenia one of Russia's "closest partners," Medvedev indicated that Russia sought additional ways to assist Armenia during the crisis, including "special economic mechanisms" and "guarantees."

16. (C) Volokovykh said that the GOR had decided to provide USD 500 million in credit to Armenia, but the allocation of funds was only possible once the Duma passed the new budget. Volokovykh said it was possible to discuss the terms of the loan, but it was "well understood by all" that Armenia had a history of not repaying loans, and this would be no exception.

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17. (C) Volokovykh clarified that Medvedev's remarks about using "special economic mechanisms" to assist Armenia referred to the anti-crisis fund of the Eurasian Economic Community (EurAsEC). EurAsEC members had decided to let Armenia participate in the fund, even though it was only an observer in the organization. While Russia was the biggest contributor to the fund, providing USD 7 billion of the fund's USD 10 billion total volume, EurAsEC members would have to jointly decide on the terms of aid to Armenia at their next summit in the summer. The planned USD 500 million loan would not come from the EurAsEC anti-crisis fund, Volokovykh said, despite Medvedev's April 2 remarks that the bulk of Russian aid to its neighbors would be disbursed via that fund.

18. (C) Volokovykh said that apart from the civilian nuclear cooperation, Gazprom's participation in constructing an Iran-Armenia pipeline and the modernization of the Armenian railway system with the help of the Russian Railway were the main economic issues Medvedev and Sargsian discussed. He did not have anything to add to the earlier allegations of Russian arms sales to Armenia that Russia had dismissed as forged, but stated that "military-technical" cooperation regarding the upkeep of Armenia's Soviet-era military equipment continued.

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Analysts  
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19. (SBU) Analysts are more critical of the effects of Turkish-Armenian normalization on Russia's influence in the Caucasus. In a thoughtful piece in Vermya Novostei, Ivan Sukhov allowed that a solution for Nagorno-Karabakh might be found more easily if Armenia could break out of isolation. However, Turkey's offer to open its border to Armenia in return for Karabakh settlement was a carrot Russia could not match, forcing Russia out of its position as the main mediator in the Karabakh conflict. Russia's use of the conflict to hold Armenia and Azerbaijan in its sway was trumped by Turkey's willingness to actually resolve the issue, Sukhov posited. He attributed Russia's weak hand to its mishandling of the August 2008 Georgia conflict, which

had alienated Armenia, Azerbaijan, and Turkey. Noting that this would cause Russia's "main ally in the South Caucasus" to turn toward Turkey, Sukhov judged that Russian links to Yerevan would be reduced to an "auxiliary role."

¶10. (SBU) Mikhail Zirgar and Vladimir Solovyev argued in a Kommersant article that as a result of the normalization with Turkey, Armenia would no longer rely solely on Russia as the basis of its foreign policy, in particular as increased trade with Turkey crowded out Russian economic ties. Boris Makarenko of the Political Technology Institute agreed that Russia must realize it "no longer held the monopoly on what used to be the Soviet Union," while Alexey Vlasov from Moscow State University described the new situation in the Caucasus as "multi-vectoral." However, Zirgar and Solovyev reasoned Moscow's USD 500 million loan (down from the requested USD 2 billion) would ensure Armenia went along with Russia's Nagorno-Karabakh initiatives, while quoting an MFA contact describing the Turkey-Armenia roadmap as "a PR ploy."

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Comment  
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¶11. (C) While Russia may be losing ground as the monopolist in the South Caucasus, Armenia's decision to withdraw from the NATO-Georgia PfP exercises shows that Moscow still has clout in the region, and will not lightly surrender control of its "region of privileged interests."

RUBIN